No. 01-800

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

KAREN HOWSAM, individually and as Trustee for the E. Richard Howsam, Jr. Irrevocable Life Insurance Trust dated May 14, 1982,

Petitioner,

v.

DEAN WITTER REYNOLDS, INC.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Tenth Circuit

BRIEF FOR THE SECURITIES INDUSTRY ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether the Tenth Circuit properly applied *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), in ruling that courts, not arbitrators, ordinarily must make threshold determinations of eligibility for arbitration pursuant to Section 10304 of the National Association of Securities Dealers Code of Arbitration Procedure, and that federal law governs determinations of whether the parties clearly and unmistakably agreed to arbitrate the question of eligibility.

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BRIEF FOR THE SECURITIES INDUSTRY ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF AMICUS CURIAE[1]

The Securities Industry Association ("SIA") is the principal trade association of the securities industry, bringing together the shared interests of more than 600 securities firms to accomplish common goals. The SIA member-firms (in-

[1] Pursuant to this Court's Rule 37.6, *amicus* Securities Industry Association states that no counsel for any party authored this brief in whole or in part, and no person or entity other than *amicus*, its members, or its counsel made a monetary contribution to the preparation or submission of the brief. Counsel of record for all parties have consented to the filing of this brief in letters that have been lodged with the Clerk.

cluding investment banks, broker-dealers, and mutual fund companies) are active in all United States and foreign markets and in all phases of corporate and public finance. The United States securities industry manages the accounts of approximately 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates in excess of $300 billion in revenues yearly in the United States.

Perhaps more so than any other industry in the United States, the securities industry relies upon arbitration to resolve customer disputes. As a member of the Securities Industry Conference on Arbitration ("SICA"), the SIA has been intimately involved in the evolution of the arbitration process, most notably with respect to customer-broker disputes arising from securities transactions.

This case involves the proper interpretation of a section of the National Association of Securities Dealers ("NASD") Code of Arbitration Procedure governing eligibility for arbitration before the NASD, and whether federal courts properly may resolve the threshold question of eligibility by applying federal arbitration law. The NASD is the largest securities-industry self-regulatory organization in the world. Its subsidiary, NASD Dispute Resolution, Inc., handles over 90 percent of all securities-related disputes through arbitration or mediation.

It is critically important to the SIA that member firms not be forced to arbitrate disputes they did not agree to arbitrate, including stale disputes ineligible for arbitration under NASD rules. It is equally important that there be uniformity in the application of the NASD eligibility rule. Significantly, the vast majority of SIA members have nationwide operations, and a patchwork of rules would undermine the Congressional policy favoring national markets. The SIA therefore has a vital interest in the correct resolution of this case.

STATEMENT

The NASD has adopted a comprehensive Code of Arbitration Procedure (the "NASD Code") governing dispute resolution for those who choose to arbitrate before the NASD. Provisions of the NASD Code are deemed a part of and incorporated by reference into every agreement to arbitrate under NASD rules. *See* NASD Code § 10331, NASD Manual (CCH) ¶ 7601.

The NASD Code, which was approved by the Securities and Exchange Commission ("SEC") after public notice and opportunity for comment, includes an eligibility provision governing the time within which disputes must be submitted to arbitration:

> 10304. Time Limitation Upon Submission
>
> No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy. This Rule shall not extend applicable statutes of limitations, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

NASD Manual (CCH) ¶ 7574. *See generally* NASD Notice to Members 80-34, 1980 NASD LEXIS 312 (July 17, 1980) (noting NASD had received approval from the SEC of a "thorough revision to its Code of Arbitration Procedure"); NASD Notice to Members 71-23, 1971 NASD LEXIS 23 (July 23, 1971) (publishing proposed amendments to NASD Code of Arbitration Procedure for comment by NASD members and noting that all proposals must be "submitted to and not disapproved by" the SEC before becoming effective).

The NASD Code formed the basis of the Uniform Code of Arbitration formulated by the SICA, an advisory body

which included public representatives. *See* NASD Notice to Members No. 80-34, *supra*. The Uniform Code of Arbitration, and the eligibility rule it included, were adopted in full by other self-regulatory organizations. *Id.* Consequently, the New York Stock Exchange and the American Stock Exchange each have eligibility rules identical to the NASD rule. New York Stock Exchange Arbitration Rules, New York Stock Exchange Guide (CCH) ¶ 2603 (Arbitration Rule 603); American Stock Exchange Guide (CCH) ¶ 9544 (Arbitration Rule 605).

As a client of Dean Witter Reynolds, Inc. ("Dean Witter"), Petitioner Howsam entered into a standard customer service agreement ("1992 Agreement") that contained an arbitration clause requiring the parties to arbitrate "all controversies . . . concerning or arising from" Dean Witter's account-related services. In March 1997, Petitioner commenced an arbitration proceeding before the NASD pertaining to advice and investment recommendations allegedly made by Dean Witter in March and April 1986. Petitioner executed a Submission Agreement stating that she agreed to abide by "the Constitution, By-Laws, Rules, Regulations, and/or Code of Arbitration Procedure of the sponsoring organization," i.e. the NASD.

In July 1997, Dean Witter filed a complaint in the United States District Court for the District of Colorado, seeking (*inter alia*) a declaration that Petitioner's claims were ineligible for arbitration under Section 10304. Petitioner moved to dismiss the complaint for lack of jurisdiction, asserting that the district court could not decide the issue of eligibility under Section 10304 because the 1992 Agreement required Dean Witter to arbitrate "all controversies . . . concerning or arising from" Dean Witter's account-related services. Petitioner further argued that only an arbitrator could decide the eligibility issue because the 1992 Agreement contained a choice of law provision selecting New York state law as gov-

erning, and because the New York Court of Appeals, applying Second Circuit case law, had ruled in 1997 that parties who agree to arbitrate "all controversies" must also arbitrate disputes regarding eligibility under Section 10304.

The District Court granted Petitioner's motion, concluding that under New York decisional law, the 1992 Agreement provided "clear and unmistakable evidence" that the parties intended to submit all issues, including the issue of eligibility, to the NASD arbitrators.

The Court of Appeals for the Tenth Circuit reversed. The Court of Appeals first ruled that federal law governed the determination of whether the parties had "clearly and unmistakably" agreed to arbitrate the question of eligibility, because the Federal Arbitration Act ("FAA") created a substantive body of federal law governing arbitrability, and the parties' general choice-of-law clause did not require the court to apply New York law on arbitrability. Then, applying federal arbitration law, rather than New York law, the Court of Appeals concluded that Section 10304 raised a threshold question of arbitrability, and that there was not "clear and unmistakable" evidence that the parties had agreed to arbitrate that question. Accordingly, the Court of Appeals concluded that the question of eligibility could be resolved by the court, and remanded to the District Court for further proceedings.

Petitioner sought review, asking this Court to resolve whether, given the arbitration agreement between the parties in this case, the eligibility question should be decided by a court or by the arbitrators.

SUMMARY OF ARGUMENT

The Court of Appeals properly determined that the eligibility rule of Section 10304 raises a threshold question of arbitrability that ordinarily must be decided by courts, not arbitrators. The text, history and purpose of the rule reveal that the eligibility provision operates as a bright-line contractual

limitation on the disputes the parties agreed to submit to arbitration before any dispute arose, rather than a rule that varies in its application based on the conduct of the parties after a dispute arises. Pursuant to this Court's ruling in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the threshold question of eligibility therefore must be resolved by courts, not arbitrators, unless the parties "clearly and unmistakably" agree otherwise.

It is vitally important that arbitrators not make eligibility determinations unless the parties have clearly and unmistakably agreed to arbitrate that issue. The eligibility rule is an integral part of the parties' arbitration agreements and defines arbitral jurisdiction. Parties who agree to arbitrate waive certain rights and protections attendant to litigation in court, including the right to judicial review of incorrect determinations on matters of law. Contractual limitations on the scope of that waiver must be honored.

On a practical level, requiring arbitrators to make eligibility determinations substantially undermines the effectiveness of the eligibility rule. Because the NASD arbitration rules do not emphasize summary resolution of disputes based on prehearing motions, arbitrators faced with a dispute regarding whether the six-year eligibility period has elapsed often defer resolving that dispute until the end of the arbitration proceedings, after they have heard all other issues in the case. *See* Notice of Filing of Proposed Rule Change by NASD Relating to the Eligibility of Claims for Arbitration, 63 Fed. Reg. 588, 590 (Jan. 6, 1998) (noting that arbitrators "tend to delay eligibility decisions until the hearing on the merits"). Parties are often thus forced to spend time and money arbitrating the substantive merits of ineligible, stale claims that they did not agree to arbitrate, after memories have faded and other evidence has been lost. In addition, because arbitrators are not required to detail the reasons for their decisions, it is often impossible to determine whether an award impermissibly

permits recovery for an ineligible claim, and therefore impossible to obtain effective review of incorrect eligibility determinations.

The eligibility rule represents a fair contractual limitation on the age of disputes that may be arbitrated. The rule was adopted by the NASD, embraced by the SICA – an advisory body that (like the NASD Board of Governors) includes public representatives – and approved by the SEC. The eligibility rule thus represents the collective judgment of industry and non-industry representatives alike that six years strikes a proper balance between claims that may and claims that may not be allowed to proceed to arbitration. Indeed, Petitioner acknowledges that the six-year eligibility period is tied to the length of time the SEC requires broker-dealers to retain their records. The limitation therefore guards against the pursuit of claims in arbitration when the underlying records may no longer exist.

Finally, the Court of Appeals properly concluded that federal law governs whether or not there exists "clear and unmistakable" evidence of an intent to arbitrate the eligibility issue. The FAA created a substantive body of federal arbitration law in order to ensure uniform enforcement of agreements to arbitrate. It is vital that the securities industry, which is national in scope, have uniformity and certainty in how its standard arbitration agreements are interpreted, so that members are not forced to arbitrate stale claims they rightfully believed were no longer eligible for arbitration. Although ordinary questions of fact regarding contract interpretation may be resolved by turning to state law, the question of whether the parties "clearly and unmistakably" expressed an intent to arbitrate the arbitrability question is properly a matter of federal law. General choice-of-law clauses do not provide sufficient evidence of the requisite intent to arbitrate eligibility. Any other conclusion would undermine the purposes of the FAA by reversing the estab-

lished presumption against arbitrating threshold questions of arbitrability, thereby forcing parties to arbitrate disputes they did not contractually agree to arbitrate.

ARGUMENT

A. Under *First Options*, Arbitrators May Not Resolve Disputes Regarding Eligibility Absent "Clear And Unmistakable" Evidence That The Parties Intended To Arbitrate Those Disputes

The core legal principles underlying this case are well established. This Court has long acknowledged that "[a]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *AT&T Techs., Inc. v. Communications Workers of America*, 475 U.S. 643, 648 (1986) (citations and internal quotations omitted). *See also* Petitioner's Brief at 6 ("Parties are not required to arbitrate unless they have agreed to do so."). In *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943-44 (1995), this Court applied that fundamental principle in ruling that because issues of arbitrability affect the contractually-conferred jurisdiction of the arbitral forum, those issues will not be submitted to arbitration unless the parties have "clearly and unmistakably" manifested their intent to arbitrate them.

First Options involved an attempt by a stock trade clearing firm (First Options) to arbitrate a dispute that had arisen with two individuals (Mr. and Mrs. Kaplan) and Mr. Kaplan's wholly-owned company (MKI). *Id.* at 940. Of the three parties against whom arbitration was sought, only MKI had signed a document containing an arbitration clause. *Id.* at 941. The individuals denied that their dispute with First Options was arbitrable, and filed written objections to that effect with the arbitration panel. Although they objected to the authority of the arbitrators, the individuals proceeded with the arbitration. *Id.* at 946-47. The arbitrators concluded that they had the authority to rule on the merits of the dispute, and entered an award in favor of First Options. *Id.* at 941. The federal district court confirmed that award, rejecting the individuals' request that the district court vacate the award pursuant to 9 U.S.C. § 10 on the grounds that the arbitrators had exceeded their authority. *Id.* On appeal, the Third Circuit reversed, agreeing with the individuals that the dispute was not arbitrable against them. *Id.*

This Court granted certiorari. *Id.* In affirming the decision of the Third Circuit, and in accordance with long-standing precedent, the Court recognized that the answer to who must resolve questions of arbitrability depends on what the parties agreed about that particular question, because "a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration." *Id.* at 945. If the parties agreed to allow an arbitrator to resolve arbitrability, then the court must defer to the arbitrator's rulings on that matter. If the parties did not so agree, the courts shall review the issue de novo. *Id.* at 943.

The Court cautioned, however, that state law principles governing contract interpretation are modified by the "important qualification" that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clear and unmistakable' evidence that they did so." *Id.* at 944. Heightened evidence of intent to arbitrate questions of arbitrability is necessary because parties to an arbitration agreement "often might not focus upon" the question of who should decide questions of arbitrability, "or upon the significance of having arbitrators decide the scope of their own powers." *Id.* at 945.

First Options thus makes clear that the law treats silence or ambiguity regarding who decides arbitrability differently from the way it treats silence or ambiguity regarding whether the parties agreed to arbitrate a particular merits-related dispute. *Id.* at 944-45. Whereas silence on a dispute related to the merits of a claim or the procedure to be applied by the

arbitrator to resolve the claim gives rise to a presumption of arbitrability, silence on the question of who decides whether the parties have agreed to arbitrate the dispute does not. This presumption against arbitrating the question of arbitrability is necessary lest courts "too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide." *Id.* at 945.

Because Section 10304 raises a question of arbitrability, the construction and application of that eligibility provision in any particular case cannot be arbitrated absent "clear and unmistakable" evidence that the parties agreed to arbitrate it.

1. The NASD Eligibility Rule Contractually Limits The Disputes The Parties Agreed To Arbitrate, And Thus Raises An Issue Of Arbitrability That Arbitrators Ordinarily Should Not Resolve

The NASD eligibility rule is incorporated by reference into every agreement to arbitrate before the NASD. *See* NASD Code § 10331, NASD Manual (CCH) ¶ 7601. Contrary to the assertions made by Petitioner and by *amicus* SEC, the rule therefore does not function as an ordinary procedural limitation on the timeliness of a party's claim after the claim accrues, or a party's ability to prosecute the claim once it is submitted to arbitration. Instead, it operates as a contractual limitation on an arbitrator's power to consider the claim at all. The history and language of the NASD eligibility rule confirm the fundamental difference between determinations regarding eligibility and determinations regarding compliance with applicable statutes of limitation.[2]

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[2] The eligibility rule's function as a contractual limitation on the parties' agreement to arbitrate undermines Petitioner's argument that Section 10304 presents a mere "procedural" issue of timeliness that arbitrators ordinarily must resolve. *See* Petitioner's Brief at 25-29. In any event, use of labels such as "procedural"

[Footnote continued on next page]

The securities industry has long depended on arbitration as a cost-effective, efficient means of resolving disputes. *See generally* General Accounting Office, "Securities Arbitration: How Investors Fare," GAO Report GAO/GGD 92-74, at 4, 6, 7, 35 (May 1992) ("1992 GAO Report") (concluding that there is no evidence of bias against investors in industry-sponsored arbitration fora); *see also* Emil Bukhman, *Time Limits on Arbitrability of Securities Industry Disputes Under the Arbitration Rules of Self-Regulatory Organizations*, 61 Brook. L. Rev. 143 (1995). The New York Stock Exchange, for example, was arbitrating disputes as long ago as 1872. *See* 1992 GAO Report, at 18; *Bukhman* at 146 & n.13.

Arbitration has, on the whole, been highly salutary and has often been used as an efficient and fair way to resolve disputes between brokerage firms, between firms and their employees, and also between firms and their institutional and individual investors. *See, e.g.*, NASD Code § 10101, NASD Manual (CCH) ¶ 7511 (setting forth matters that may be arbitrated before the NASD); *see also* 1992 GAO Report.

Notwithstanding its substantial benefits, the arbitration process has certain inherent limitations. Whereas arbitration works well in resolving factual disputes in specialized subject-matter areas or arising in specific industries, it does not function as well in resolving issues of law. The streamlined process of arbitration typically does not emphasize summary resolution of disputes on the basis of dispositive pre-hearing motions. *See* NASD Code § 10321, NASD Manual (CCH) ¶ 7584-85 (setting forth provisions governing pre-hearing proceedings and stating that unresolved pre-hearing issues

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[Footnote continued from previous page]
arbitrability and "substantive" arbitrability does not determine who should resolve the issue. Either the parties clearly and unmistakably agreed to allow the arbitrator to resolve questions regarding arbitrability, or they did not. *See First Options*, 514 U.S. 938.

may be referred to the full panel for resolution); New York Stock Exchange Rule 619(d) (same); American Stock Exchange Rule 607(d) (same). In addition, arbitrators are not required to provide the reasons for their decision (*see* NASD Code § 10330(e), NASD Manual (CCH) ¶ 7587; New York Stock Exchange Rule 627(e); American Stock Exchange Rule 618(e)), and their awards are not subject to judicial review for ordinary errors of law. *See* 9 U.S.C. § 10 (grounds for vacatur).

These inherent limitations have presented difficulties in preventing the arbitration of stale claims. For nearly a century, the only restrictions on the age of cognizable disputes were the underlying statutes of limitations. *See* 6 Securities Arbitration Commentator ("SAC") No. 8, at 10 (September 1994) (excerpts of letter from the late William J. Fitzpatrick to SEC discussing history of eligibility rule in connection with proposed amendment to that rule[3]). But because factors to be considered in applying statutes of limitations (factors such as equitable doctrines of tolling, estoppel, and waiver) tended to be considered in connection with evaluating the substantive merits of the case, and because arbitrators did not always apply statutes of limitations properly, respondents in arbitration proceedings often found themselves forced to arbitrate claims that were up to 20 years old, long after records were lost or destroyed, memories faded, and in some cases after the principals to the arbitration had died. *Id.* The benefits of choosing arbitration were diminishing as respondents were being forced to spend time and money arbitrating stale claims while awaiting the arbitrator's determination on timeliness.

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[3] Mr. Fitzpatrick was former General Counsel of the SIA, served as a representative on SICA, and therefore was involved in and familiar with the development of the eligibility rule.

The NASD acted to counteract this considerable threat to the efficiency and fairness of the arbitration process at the time that it created its own dispute resolution forum in 1968. *Id.* As the NASD later explained, "the securities industry believed that the inherently equitable nature of arbitration posed a greater risk that arbitrators might not strictly apply legal defenses," thereby permitting recovery in cases that should never have been heard at all. Notice of Filing of Proposed Rule Change by NASD Relating to the Eligibility of Claims for Arbitration, 63 Fed. Reg. 588, 590 (Jan. 6, 1998). Consequently, the NASD included an eligibility rule as part of its first arbitration code. *See* 6 SAC No. 8, at 10.[4]

The text of the eligibility rule confirms what is already evident from its history and purpose: that the rule does not operate as a run-of-the-mill statute of limitations providing a defense on the merits of a claim, but rather defines contractually the limits on the availability of the arbitral forum itself. The rule refers not to timeliness of claims, but to "eligibility" for submission to arbitration:

> No dispute, claim or controversy shall be *eligible for submission to arbitration* under this Code in any instance where six (6) years have elapsed from the occurrence or event giving rise to the act or the dispute, claim or controversy.

NASD Code § 10304, NASD Manual (CCH) ¶ 7574 (emphasis added).[5] By its plain terms, Section 10304 thus deems

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[4] Petitioner concedes that the rule was designed to "prevent stale claims from going to arbitration." Petitioner's Brief at 15.

[5] The rule further states that the eligibility period does not "extend applicable statutes of limitations," thereby confirming the distinction between threshold eligibility determinations and deter-

[Footnote continued on next page]

claims more than six years old to be ineligible for submission to arbitration in the first instance. *See, e.g., PaineWebber Inc. v. Hartmann*, 921 F.2d 507, 513 (3d Cir. 1990) (analyzing definitions of "eligible" and "submission" to conclude that NYSE eligibility rule bars access to arbitration).

Because the eligibility rule thus contractually limits the scope of an arbitrator's authority to hear a dispute, determinations regarding eligibility, unlike determinations regarding compliance with statutes of limitations, do not depend on equitable factors such as the conduct of the respective parties after a dispute arises, nor on questions of who was at fault for the passage of time between the accrual of a cause of action and the date a claim was filed. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*, 62 F.3d 381 (11th Cir. 1995) (NASD eligibility rule not subject to equitable tolling); *see also Ohio Co. v. Nemecek*, 98 F.3d 234 (6th Cir. 1996) (NYSE eligibility time period not subject to equitable tolling); SEC Exchange Act Release No. 34,442, 59 Fed. Reg. 39,373 (Aug. 2, 1994) (noting in connection with proposed amendment to eligibility rule that tolling "historically" is not applicable to that rule); Bukhman, *supra*, 61 Brook. L.

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minations based on the underlying applicable statutes of limitations. NASD Manual (CCH) ¶ 7574; *see also* SEC Release No. 34-39487, *supra*, 63 Fed. Reg. at 594 (commenting in connection with proposed amendments that there exists a "difference between eligibility and statutes of limitation, a distinction that has occasionally been overlooked by courts, arbitrators and other participants"). The NASD Arbitrator's Manual similarly confirms that determinations of eligibility under Section 10304 are separate and apart from determinations of timeliness under applicable statutes of limitations. *See, e.g.*, NASD Arbitrator's Manual, at 11 ("The arbitrators should also be aware that a statute of limitations may preclude the awarding of damages even though the claim is eligible for submission to arbitration.").

Rev. at 188, 196 (concluding that equitable doctrines such as tolling do not apply to the eligibility rule).

Instead, eligibility determinations hinge on a single, objective factor: how much time elapsed from the date of the underlying dispute, claim or controversy to the date that dispute, claim or controversy was submitted to arbitration.[6] The bright-line eligibility provision thus functions as an essential filter, protecting the integrity and fairness of the arbitration process by eliminating stale claims at the outset. Differences in who ordinarily should determine eligibility for arbitration versus who ordinarily should determine timeliness under statutes of limitations flow naturally from the different purposes to be served by and the different factors to consider in applying the two separate limitations. The responsibility for making determinations of eligibility properly falls to courts, not arbitrators, unless the parties clearly and unmistakably agree otherwise.[7]

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[6] Because eligibility determinations thus do not depend on interpretation or application of the parties' agreement regarding their commercial obligations, this Court's ruling in *John Wiley & Sons v. Livingston*, 376 U.S. 543 (1964) is not dispositive. The question in *John Wiley* was not whether a claim fell outside the scope of the agreement to arbitrate because of the passage of time, but rather whether the claimant had waived its right to arbitrate a grievance by failing to follow certain specific contractual steps. The opinion in *John Wiley* does not stray from the fundamental premise that parties cannot be forced to arbitrate beyond the bounds of their agreement. *See id.* at 547 ("[C]ompulsory submission to arbitration cannot precede judicial determination that the [parties'] agreement does in fact create such a duty.")

[7] In fact, Section 10304 states that it would not apply to "any case which is directed to arbitration by a court of competent jurisdiction," thereby preserving the ability of courts to make binding eligibility determinations.

2. The Six-Year Eligibility Rule Represents A Fair And Appropriate Limitation On The Age Of Arbitrable Disputes

Notwithstanding Petitioner's suggestion to the contrary (*see* Petitioner's Brief at 8, 14-16), both the concept of an eligibility rule and its six-year duration were the product of a collaborative effort between the securities industry and the public. The rule represents an abundantly fair limitation on the age of arbitrable disputes. Significantly, the eligibility rule applies to *all* disputes before the NASD, including disputes between members, disputes between members and their employees, and disputes between members and large, sophisticated institutional customers, not only to disputes between members and individual customers. *See* NASD Manual (CCH) ¶ 7511-12 (NASD Code § 10101); *id.* ¶ 7574 (NASD Code § 10304).

As noted above, the eligibility rule first emerged as part of the Code of Arbitration Procedure adopted by the NASD in 1968. Before it became effective, the Code was adopted by the NASD Board of Governors. *See generally* NASD Manual (CCH) ¶ 1101 ("The NASD shall have ultimate responsibility for the rules and regulations of the Association and its operation and administration."). The majority of the governors on the NASD Board of Governors are from outside the securities industry. *See* NASD Manual (CCH) ¶ 151; *see also* NASD By-Laws, Art. VII, § 4(a).

The NASD, like all other self-regulatory organizations, is subject to oversight by the SEC, including review and approval by the SEC of any rules or rule changes proposed by the NASD. *See, e.g.*, 15 U.S.C. § 78s(b)(1); *see also* NASD Notice to Members 80-34, *supra* (noting that the SEC had approved a "thorough revision to [the NASD] Code of Arbitration Procedure" in order to make NASD arbitration procedures uniform with those of other self-regulatory organizations); 1971 NASD LEXIS 23 (July 23, 1971) (noting that

proposed amendments to by-laws and Code of Arbitration Procedure would have to be submitted to and not disapproved by the SEC before becoming effective); *see generally* General Accounting Office, "Securities and Futures: How the Markets Developed and How They Are Regulated," GAO Report GAO/GGD 86-26, at 39 (May 15, 1986) (SEC provides oversight of SROs by, among other things, reviewing and approving SRO rules and rule changes); *see also id.* at 40 (describing process for review and approval, noting rules are first approved by governing body of the SRO itself, and then by the SEC); 1992 GAO Report, at 14 (noting that SEC approves SRO rules and inspects SRO operations, including arbitration).

The eligibility rule exemplifies the extent of public involvement in shaping the rulemaking process. The SICA was formed in 1977, at the instance of the SEC, to review then-existing procedures in place for arbitration before self-regulatory organizations. *See* 1992 GAO Report, at 15. The SICA consisted, and still consists, of not only industry representatives, but also of members of the general public. *Id.* After lengthy negotiations and examination of existing procedures, SICA proposed its Uniform Code of Arbitration, which included the NASD eligibility rule. *Id.* at 15, 20; *see also* 63 Fed. Reg. at 590. All self-regulatory organizations – such as the New York Stock Exchange and the American Stock Exchange – adopted the Uniform Code in the late 1980s, and since then, all have had the same eligibility bar on disputes that may be submitted to arbitration. *Id.*

This process of public scrutiny has resulted in an eligibility rule which strikes a fair balance between the rights of a potential claimant to pursue a claim and the rights of a potential respondent to be free from any obligation to defend against stale claims. Indeed, as the result of the collaborative process, the NASD eligibility rule, originally set at a two-year bar, was amended and extended because the two-year

period was too short. *See* 6 SAC No. 8, at 10 (printing excerpts of letter from William J. Fitzpatrick to the SEC). The current six-year period was chosen because it conforms to the length of time the SEC requires broker-dealers to keep records of certain transactions. *Id.*; *see also* Petitioner's Brief at 15; 17 C.F.R. § 240.17a-4 (most records need only be kept for three years or six years, depending on the type of record); 63 Fed. Reg. at 590 (discussing history of eligibility rule in connection with proposed amendment to that rule). By approving an eligibility rule tied to the books-and-records rule, the SEC expressed its judgment that six years represented the proper balance between allowing claims to go forward and requiring them to be brought before they become stale.[8]

3. Interpreting The NASD Code As Requiring Arbitrators To Determine Eligibility Hampers The Dispute Resolution Process

Interpreting the NASD eligibility provision as just another rule to be applied by arbitrators, rather than a contractual limitation on the arbitrators' authority, would have a significant, adverse impact on the vitality of the NASD dispute resolution process as a whole.

Requiring allegedly aggrieved persons to bring their claims to arbitration before they become prejudicially stale has become increasingly important in the years since this Court ruled that securities-related claims are arbitrable. *See Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987); *see also Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). The number of claims

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[8] Petitioner's admission that "few claims have statutes of limitation as long or greater than six years" (Petitioner's Brief at 15) recognizes that legislatures have deemed periods of less than six years to be adequate limitations on an investor's ability to pursue a securities claim.

submitted to arbitration has more than doubled during that time, from fewer than 3,000 claims submitted to the NASD alone in 1987, to nearly 7,000 claims submitted to the NASD in 2001. *See* NASD, *Securities Regulation in the United States*, at 41-42 (1992) (Five Year Statistical Review, 1987-1992, reflecting claims filed during that period); NASD Dispute Resolution Statistics, *available at* www.nasdadr.com/statictics.asp (reflecting arbitration statistics through year-end 2001 and projected statistics for 2002); *see also* 1992 GAO Report, at 18 (number of cases filed with SROs increased from 830 cases filed in 1980 to 5,332 in 1990).

During that same time, arbitration has grown more complex, and therefore more costly and time-consuming. In order to continue subsidizing the operating costs of arbitration, the NASD raised the fees imposed on all those who are named parties to the arbitration – fees that are not refundable regardless of the outcome of the proceedings. *See* NASD Notice to Members 98-1, 1998 NASD LEXIS 2 (Jan. 1998) (announcing new arbitration process fee to be assessed on members that are parties to arbitration proceedings); *see also* Order Granting Approval to Proposed Rule Change Relating to Fees and Hearing Session Deposits for the Arbitration of Claims by Public Investors, Members and Associated Persons, SEC Exchange Act Release No. 34-41056, 64 Fed. Reg. 10,041 (Mar. 1, 1999). Only claims designated as small claims (claims with less than $25,000 at issue) may be resolved without a hearing; claims exceeding $50,000 must be heard by a panel of three arbitrators. *See* 10 SAC No. 6, at 13 (Mar. 1999). The vast majority of arbitration claims filed with self-regulatory organizations are not small claims cases. *See, e.g.*, 10 SAC No. 8, at 17 (May 1999) (reflecting total and small claims arbitration filings for 1996-1998).

Arbitration has also become more litigious and subject to gamesmanship with the emergence over the past decade of a

"cottage industry" of claimants' law firms specializing in securities arbitration. A nationwide bar association of attorneys "dedicated to the representation of investors in disputes with the securities industry" has emerged, and has established a website through which allegedly aggrieved claimants may search for an attorney who meets "strict membership requirements" to help them pursue their claims. *See, e.g.*, website of Public Investors Arbitration Bar Association website, www.piaba.org/about.asp. (stating that organization was "established . . . as an educational and networking organization for securities arbitration attorneys who represent the public investor in securities disputes"). In connection with proposed amendments to the eligibility rule, the NASD has recognized the "[t]actical maneuvering" that has taken place by parties who "attempt to gain an advantage by filing a claim or a motion in the forum they believe will produce a favorable ruling" on eligibility. 63 Fed. Reg. at 590.

Given the complexity of and rising costs associated with arbitration, it has become increasingly important that contractual limitations on agreements to arbitrate be honored. Allowing courts to determine eligibility reduces the risk of either intentional or de facto non-enforcement by arbitrators. The NASD has noted that attempts to enforce the eligibility provision through arbitration itself "have had mixed success because arbitrators tend to delay eligibility decisions until the hearing on the merits." *Id.* Claimants with stale claims sometimes attempt to circumvent the six-year eligibility bar by casting as "claims" what are in reality impermissible equitable arguments (such as tolling or asserted failure to discover the basis for their claim) to extend the six-year eligibility period. *See, e.g., PaineWebber Inc. v. Hofmann*, 984 F.2d 1372, 1381-82 (3d Cir. 1993). In these instances, a strong temptation exists for the arbitrators to resolve the factual dispute regarding eligibility simultaneously with resolving the factual disputes regarding the substantive merit of the claims.

This tendency to defer a ruling on eligibility until after adjudication of the merits clearly threatens the purpose of the rule, and creates the very risks the eligibility rule was intended to avoid: the risks that broker-dealers and others in the securities industry will be forced to spend time and money arbitrating ineligible stale claims, and that arbitrators would be reluctant to dismiss a claim as ineligible after having heard full arguments and evidence on the merits. These risks interject an impermissible degree of uncertainty into an otherwise clear-cut rule. Determinations regarding eligibility should not be made by arbitrators, who may apply varying standards and whose rulings on eligibility are insulated from effective challenge, unless the parties clearly and unmistakably indicate their desire to arbitrate that critical initial issue.[9]

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[9] This Court's opinion in *First Options* conclusively dispenses with the argument made by *amicus* SEC that courts should not decide questions of eligibility because, notwithstanding the language of the eligibility rule, the parties "likely intended that the arbitrator would decide" whether the claims were timely filed, and that, in any event, allowing courts to make eligibility determinations would make arbitration more costly and less expedient. *See* SEC *Amicus* Brief at 25. As this Court noted in *First Options*, determinations of whether the parties agreed to arbitrate the question of arbitrability do not depend on what the parties "likely intended," but rather hinge on what the parties "clearly and unmistakably" agreed. *See* 514 U.S. at 945. In addition, as this Court also noted, the "basic objective" of arbitration "is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes," but rather "to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." *Id.* at 946-47 (internal quotations omitted). Furthermore, the expediency argument advanced by the SEC fails to address the inefficiency of forcing parties who are unable to resolve the eligibility issue through pre-hearing proceedings to arbitrate the substantive merits of stale claims while awaiting the arbitrators' decision regarding eligibility. *See* Section A.3, *supra*.

4. The Principles Underlying The Federal Arbitration Act Are Best Served By Allowing Courts To Determine Eligibility Unless The Parties Clearly And Unmistakably Agree Otherwise

Treating a dispute regarding eligibility as a matter for courts to decide absent "clear and unmistakable" evidence of an intent to arbitrate that question also best serves the purposes of the FAA.

The FAA was enacted in 1925 in order to provide uniformity in enforcing agreements to arbitrate and to place such agreements on equal footing with any other contract. *See, e.g., Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 534 U.S. 279, 122 S. Ct. 754, 761-62 (2002). To this end, the FAA created a federal body of substantive law governing arbitration, to be applied uniformly regardless of the jurisdiction in which enforcement of an agreement is sought. *See, e.g., Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). The FAA thus represents an important policy decision in favor of enforcing arbitration agreements according to their terms. As noted above, this Court has confirmed that the policy favoring arbitration extends to arbitration of securities-related disputes. *See McMahon, supra*; *Rodriguez de Quijas, supra*.

Implementing that policy requires courts to remain mindful that, as Petitioner acknowledges, "[r]esolution of disputes through arbitration is a matter of agreement" and that "[p]arties are not required to arbitrate unless they have agreed to do so." Petitioner's Brief at 6. Parties who agree to submit disputes to arbitration relinquish substantial rights, including the right to appeal an incorrect decision, the right to have a jury resolve the merits of their action, and, depending on the rules of the forum, the right to have factually or legally baseless claims dismissed through pre-hearing motions. But they relinquish those rights only as to the disputes they contractually agree to arbitrate. Just as parties may

agree to submit certain disputes to arbitration, they may contractually agree that certain other disputes are exempt from arbitration. In Petitioner's words, "arbitrators have authority to resolve disputes only because the parties agreed in advance to submit them to arbitration." Petitioner's Brief at 18.

The FAA therefore includes three separate provisions designed to ensure that arbitration agreements are enforced according to, and only according to, their terms. Two of those provisions empower courts to make pre-arbitration decisions regarding arbitrability. Section 3 requires a court to stay proceedings pending before it "upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration" under a written arbitration agreement. 9 U.S.C. § 3. Similarly, Section 4 requires a court to compel arbitration "in accordance with the terms of the agreement" to arbitrate "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue." 9 U.S.C. § 4. A third section – Section 10 – empowers courts to make post-arbitration decisions regarding arbitrability and to vacate arbitration awards where the arbitrators "exceeded their powers." 9 U.S.C. § 10. This Court has confirmed that arbitrators "exceed[] their powers" when they attempt to resolve issues the parties never agreed to submit to arbitration. *See First Options*, 514 U.S. at 946-49 (affirming Court of Appeals' reversal of award confirmation on the grounds that the dispute was not arbitrable as against those parties).

This Court's previous rulings underscore that courts play a critical role in determining whether or not parties to an arbitration agreement have agreed to arbitrate particular disputes. In *Moses H. Cone*, for example, one party resisted arbitration by arguing, among other things, that arbitration was barred under a provision of the parties' contract limiting the age of disputes that could be submitted to arbitration. *See* 460 U.S. at 5 n.2. The Court noted that "the basic issue presented" in the federal suit "was the arbitrability of the dis-

pute" (*id.* at 24), and concluded that the Court of Appeals "acted within its authority in deciding the legal issues presented" after reviewing "full briefs and evidentiary submissions from both parties on the merits of arbitrability." *Id.* at 29.

Similarly, the collective bargaining agreement at issue in *AT&T Technologies, Inc.* contained an exclusion limiting the types of disputes that could be submitted to arbitration. This Court ruled that it was up to the court, not the arbitrator, to determine whether or not a particular grievance fell within the scope of that exclusion. 475 U.S. at 651. Were the rule any different, the Court observed, "an arbitrator would not be constrained to resolve only those disputes that the parties have agreed in advance to settle by arbitration, but, instead, would be empowered to impose obligations outside the contract limited only by his understanding and conscience." *Id.* (internal quotation and citation omitted).

Like the provisions at issue in *Moses H. Cone* and *AT&T Technologies*, the NASD eligibility rule operates as a contractual limitation on the scope of disputes the parties agreed to arbitrate. By agreeing to arbitrate before the NASD, the parties agreed to submit to arbitration only those disputes eligible for arbitration under NASD rules. The text of the FAA and this Court's decisions interpreting and applying it confirm that arbitrators ordinarily cannot make threshold determinations of eligibility absent clear and unmistakable evidence that the parties agreed to arbitrate that initial question.[10]

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[10] Petitioner's admission that questions of arbitrability are presumptively for courts to decide (*see* Petitioner's Brief at 27) undermines Petitioner's later assertion (*see id.* at 32) that those who agree to arbitrate "any and all controversies" necessarily must have meant to arbitrate the very question of arbitrability itself.

B. The Court Of Appeals Properly Applied Federal Arbitration Law In Determining That The Parties Had Not "Clearly And Unmistakably" Demonstrated An Intent To Arbitrate Eligibility

Petitioner contends that the Court of Appeals should have followed the ruling of the New York Court of Appeals in *Smith Barney Shearson Inc. v. Sacharow*, 689 N.E.2d 884 (N.Y. 1997) and ruled that the parties "clearly and unmistakably" manifested their intent to arbitrate the question of eligibility under Section 10304. *Amicus* respectfully disagrees.

As the Court noted in *First Options*, ordinary state law principles of contract interpretation are modified by the federal arbitration law principle that parties are not presumed to have agreed to arbitrate arbitrability unless they have "clearly and unmistakably" manifested their intent to do so. *First Options*, 514 U.S. at 944. The question of whether or not particular language constitutes "clear and unmistakable" evidence of an intent to arbitrate eligibility raises a question of federal arbitration law regarding the allocation of power between courts and arbitrators, and therefore must be decided under federal law unless the parties clearly agree otherwise. *See, e.g., Sovak v. Chugai Pharm. Co.*, 280 F.3d 1266, 1270 (9th Cir. 2002) (federal law supplies the rule of decision for determining whether a party waived right to compel arbitration because that question "directly concerns the allocation of power between courts and arbitrators").

Quite simply, *Sacharow*, and the cases upon which it relied, are wrongly decided. The court in *Sacharow* first correctly determined that the NASD eligibility rule raises a threshold question of arbitrability, which cannot be arbitrated absent clear and unmistakable evidence that the parties intended to arbitrate that question. *See* 689 N.E.2d at 886-87 (eligibility rule "limits the subject of, entitlement to, and

range of arbitrable matters" and therefore presents a question of arbitrability).

The court did not, however, apply the proper presumptions in determining whether the parties had clearly and unmistakably manifested an intent to arbitrate the question of eligibility. Applying precedent from the Second Circuit Court of Appeals, the court in *Sacharow* ruled that an agreement to arbitrate "any and all controversies" provides clear and unmistakable evidence of the intent to arbitrate threshold questions of arbitrability as well. *See* 689 N.E.2d at 887-88 (applying *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996)). As further purported support for its conclusion, the court pointed to a separate provision of the NASD Code that empowers arbitrators to interpret and apply all other provisions of the NASD Code. *Id.* at 888 (citing NASD Code § 35, now NASD Code § 10324). Petitioner, not surprisingly, makes the same argument here. *See* Petitioner's Brief at 33-35. The *Sacharow* court concluded that this general clause, when coupled with the agreement to arbitrate "any and all controversies," provided clear and unmistakable evidence of the intent to allow arbitrators to make threshold determinations of eligibility.

This flawed reasoning ignores the presumptions established in *First Options*, the purpose of the eligibility provision, and the primacy of the eligibility rule over more general sections of the NASD Code. As noted above, the Court ruled in *First Options* that silence or ambiguity on the question of who decides arbitrability does *not* give rise to a presumption that the parties agreed to arbitrate that threshold question. *First Options*, 514 U.S. at 944-45. Instead, there is a presumption *against* arbitrating the question of arbitrability, unless the parties have clearly and unmistakably agreed otherwise. *Id.*

The arbitration agreement at issue here, like the arbitration agreements in *Bybyk* and *Sacharow*, did not expressly

state who would decide the question of arbitrability. The Court of Appeals in this case properly concluded that by interpreting the "any and all controversies" language as an indication that the parties agreed to arbitrate the threshold question of eligibility, the courts in *Bybyk* and *Sacharow* in effect reversed the presumption against arbitrating arbitrability and created a presumption that the parties *did* agree to arbitrate threshold arbitrability issues unless they expressly carved out eligibility determinations from their arbitration agreements. *See, e.g.*, Pet. App. 24 n.7 ("We believe the *Sacharow* court gave insubstantial weight to the presumption established in *First Options* that parties to arbitration agreements generally intend arbitrability questions to be resolved by the courts."); *see also Bybyk*, 81 F.3d at 1200 ("The parties' broad grant of power to the arbitrators is unqualified by any language carving out substantive eligibility issues (with or without specific reference to timeliness) for resolution by the courts."); *Sacharow*, 689 N.E.2d at 887 (approving of and applying *Bybyk*). That is exactly the opposite of what *First Options* and *AT&T* contemplated.

The Court of Appeals also properly concluded that Section 10324 does not supply the requisite "clear and unmistakable" evidence of the intent to arbitrate eligibility. The general language of Section 10324 cannot trump the more specific language of the eligibility rule. *See, e.g.*, *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 78 F.3d 474, 480 (10th Cir. 1996) ("[I]t is well established under the generally applicable rules governing contract interpretation that specific provisions, like § 15 [predecessor to Section 10304] take precedence over more general provisions, like § 35 [predecessor to Section 10324.]") (citing *Mutual Life Ins. Co. v. Hill.*, 193 U.S. 551, 558 (1904)); *accord Cohen*, *supra*, 62 F.3d at 384. Reading Section 10324 to require arbitration of eligibility disputes ignores the gatekeeping function of the rule, which, as discussed above, was adopted in order to avoid submitting stale claims to arbitrators for any purpose.

Moreover, if a claim is not eligible for submission to the arbitrators under Section 10304, the arbitrators should never have the opportunity to consider the application of any provisions of the NASD Code.

Finally, Petitioner is wrong in asserting that the general choice-of-law clause contained in the parties' agreement somehow required the Court of Appeals to apply New York decisional law on what constitutes "clear and unmistakable" evidence of an intent to arbitrate eligibility. This Court has already ruled that a general choice-of-law provision does not signify an intent to be bound by New York arbitration law.

The parties in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995) agreed that "any controversy" arising out of the transactions between them would be resolved by arbitration in accordance with the rules of the NASD, or the Boards of Directors of the New York Stock Exchange or the American Stock Exchange. *Id.* at 59. The parties further provided that the entire agreement "shall be governed by the laws of the State of New York." *Id.* at 58-59. At the conclusion of the arbitration, which proceeded before the NASD under NASD rules, the arbitrators entered an award which included punitive damages. Shearson challenged that award on the grounds that New York law precluded arbitrators from awarding punitive damages. *Id.* at 54-55.

This Court flatly rejected the contention that the general choice-of-law provision signified the parties' intent to incorporate "New York law relating to arbitration." *Id.* at 62 (quotation marks omitted). Instead, the Court reasoned, the "best way to harmonize the choice-of-law provision with the arbitration provision" was to read the choice-of-law provision to cover the substantive "rights and duties of the parties" with respect to their commercial relationship, and the arbitration clause as governing arbitration. *Id.* at 63-64.

The decision in *Mastrobuono* thus emphasizes a principle established years earlier: that the FAA created a federal body

of substantive law governing arbitration, to be applied uniformly regardless of the jurisdiction in which enforcement of an agreement is sought. *See, e.g., Moses H. Cone*, 460 U.S. at 24. Because the FAA did not create federal question jurisdiction to enforce arbitration agreements falling within its scope, state courts often must decide whether or not to stay proceedings or compel arbitration pursuant to the FAA. In doing so, however, state courts are enforcing *federal* law, and must apply *federal* standards under the FAA. *See id.*; *see also id.* at n.32 ("[A]lthough enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by the federal courts where otherwise appropriate.").[11]

The Court of Appeals therefore properly ruled that the parties' general choice-of-law provision did not require the federal district court to adhere to a New York state court application of the federal law test of whether or not the parties agreed to arbitrate the threshold question of arbitrability. *See* Pet. App. at 23-24 ("On the arbitrability issue before us, then,

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[11] Of course, parties to an arbitration agreement remain free to agree to be bound by state law rules of arbitration. *See Volt Info. Scis., Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989). The critical issue is whether the parties did, in fact, clearly agree to be bound by those state law arbitration rules, including state court decisions regarding what constitutes "clear and unmistakable" evidence of an intent to arbitrate the question of arbitrability. In resolving this question, the "strong default presumption is that the FAA, not state law, supplies the rules for arbitration." *Sovak*, 280 F.3d at 1269-70 (citing cases and concluding that general choice-of-law clause incorporated federal rules for arbitration but state substantive law); *see also Roadway Package Sys., Inc v. Kayser*, 257 F.3d 287, 288-89 (3d Cir.), *cert. denied*, 122 S. Ct. 545 (2001) (holding that a "generic choice-of-law clause" did not signify intent to apply state law standards governing whether arbitrator exceeded the scope of his authority).

we are not governed by how the New York Court of Appeals construed similar arbitrability language, but are governed instead by the federal law of arbitrability . . . .")

Consistent application of a federal law standard is extremely important to the securities industry. Self-regulatory organizations preside over thousands of arbitrations relating to national securities marketplaces involving companies doing business nationwide. The NASD, New York Stock Exchange, and American Stock Exchange each have an eligibility provision governing access to their arbitration fora. Determinations of whether or not parties agreed to arbitrate the question of eligibility must be made according to a single, consistent federal standard of "clear and unmistakable evidence," regardless of generic choice-of-law clauses governing the parties' underlying substantive rights and obligations.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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